

REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND THE KWAZULU-NATAL PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF DANNHAUSER MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Dannhauser Municipality which comprise the balance sheet as at 30 June 2007, income statement, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 14 to 36.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in the accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003)(MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004)(PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standard on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis of an opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting as set out in the accounting policy note 1.

Basis for disclaimer of opinion

5. Property, plant and equipment

5.1 Asset register issues

An unexplained difference of R365 840 existed between the asset register total of R11,2 million and the financial statement amount of R11,5 million. The municipality's records did not permit the application of alternative auditing procedures, hence, sufficient appropriate evidence on the measurement and completeness of assets could not be obtained.

5.2 Inherited assets not recognised

No record of assets inherited from the erstwhile Hattingsspruit Transitional Local Council, following the disestablishment thereof, were maintained by the municipality. Consequently, sufficient evidence could not be obtained to validate the existence, measurement, and completeness of these assets.

6. Commitments

6.1 Commitments not supported

The completeness, accuracy, and validity of commitments totalling R14,4 million as disclosed in note 23 to the financial statements could not be ascertained due to the absence of substantiating records, as well as Council approvals for these amounts.

7. Payables

7.1 Salaries

Opening balances for salary related payables totaling R369 000 could not be verified, due to the absence of supporting documentation. Furthermore, no movements were noted in the balance, thus impacting on the validity of this amount.

7.2 Conditional grants

The measurement and completeness for the conditional grant balance of R7,3 million disclosed as part of creditors in note 10 to the financial statements could be established. This was due to the failure to maintain reconciliations and records for transactions and events pertaining to grants.

7.3 Suspense accounts

Note 10 to the financial statements includes an amount of R5,1 million for the items described as suspense and control accounts. This account was not periodically reconciled and cleared, and certain amounts included in the balance could be explained. Consequently, poor record-keeping did not permit the application of alternative auditing procedures to enable the reasonable conclusions on the completeness, accuracy and validity assertions.

8. Receivables

8.1 Difference between balance and aging analysis

Sufficient appropriate evidence and explanations were not provided for a difference of R1 million, which existed between the financial statements and receivables aging analysis amounts of R9,6 million and R8,6 million respectively. As a result, the valuation, completeness, and existence of receivables could not be established.

8.2 Consumer debtor provision understated

The consumer debtor balance increased by 54 percent since the previous year from R6,2 million (30 June 2006) to R9,6 million (30 June 2007). This increase was specifically attributed to the lack of an effective credit control policy as required by section 97 of the

Municipal Systems Act, 2000 (Act No. 32 of 2000). Moreover, the provision for bad debts was not reassessed during the year and as per the review of the age analysis, it was noted that debtors outstanding for 120 days and more amounted to R8,5 million resulting in a potential under-provision.

8.3 Validity of debtors

Debtors totaling R2,9 million on the debtors list have been outstanding since 2006 and these balances have been rolled forward since then. There is also no documentation to support their validity.

8.4 Debtors suspense not cleared

Debtor's suspense and control accounts totaling R1,5 million were not cleared at year-end. Many of these balances have been rolled forward from the prior year and there were no supporting documents to validate them.

8.5 Debtors with credit balance

Debtors with credit balance amounting to R2 million have been off-set against debtors with debit balances and not transferred to creditors or cleared at year-end.

8.6 Salary related debtors

Salary related debtors amounting to R817 149 were carried forward from the previous year and no movement was noted during the current year. Furthermore, no documentation was submitted to validate these amounts.

8.7 Land sales debtors

The accuracy, validity, and recoverability of the land sale debtors amounting to R877 870 as disclosed under current debtors could not be verified as there were no debtors listings on movement noted from prior year.

8.8 Staff debtors

There has been no movement noted on the staff debtor's amounting to R748 869. These debtors have been outstanding since the prior year. The supporting documentation could not be provided. Consequently, the validity, accuracy and recoverability could not be verified.

8.9 Vat discrepancies noted

The following discrepancies were noted during the audit of VAT:

- Differences were identified between the VAT disclosed on the VAT 201 returns and the VAT control account in the general ledger. In addition, no reconciliation was performed to enable verification of the net output VAT of R13 413.
- VAT returns were not submitted timeously, which could result in interest or penalties being paid, thereby incurring fruitless and wasteful expenditure.
- It could not be ascertained whether a reasonable formula exists between vatable and non-vatable supplies or whether this allocation is consistently applied. Furthermore, it was confirmed that the allocation has not been approved by SARS.

- It was noted that no output VAT was declared with regards to benefits to personnel or the insurance claims that were received. In terms of the VAT Act, all seventh schedule fringe benefits, that is, use of municipal cars, housing allowances, cell phone allowances and use of municipal assets are subject to output VAT on the employer providing the benefit. In addition, insurance claims on assets which were previously in accidents constitute a deemed supply in terms of the VAT Act, therefore output VAT should be charged on these. These were currently excluded from the VAT returns inspected.
- Input VAT of R146 225 was under claimed on certain invoices which were sampled.

9. Financial discrepancies

The following unexplained material misstatements/disclosure deficiencies were identified during our review of the financial statements:

- The chief financial officer's report incorrectly reflects actual operating expenditure for the 2007 year as R18,6 million instead of R19,5 million as stated in the income statement.
- A recalculation of the increase in cash investments in the cash flow statement was R2,4 million however, the cash flow statement reflected R1,4 million resulting in an understatement of R1 million.
- Note 16 of the financial statements incorrectly reflected the operating surplus for the year as R4,8 million instead of R3,9 million as recorded in the income statement.
- Note 25 of the financial statements did not record the current year movements of Public Improvement Fund resulting in an understatement of R215 187.
- Note 26 of the financial statements did not record the current year movements of the Housing Operating Account resulting in an understatement of R42 377.

Disclaimer of opinion

10. Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Dannhauser Municipality. Accordingly, I do not express an opinion on the financial statements.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Non-compliance with laws and regulations

11. Municipal Financial Management Act (MFMA)

The following instances of non-compliance with MFMA were noted:

- (a) There was no fraud prevention or risk management policy in place as required by section 62(1)(a)(i).
- (b) The recommendations made by the Auditor-General in the prior years reports have not been implemented, which is in contravention of section 131(1).
- (c) The monthly management expenditure reports as required by section 71(1) were not submitted to the Treasury as required.
- (d) There was no investment and cash management policy in place as required by section 13(2).
- (e) There was no revenue and credit management policy in place as required by section 64.
- (f) There was no expenditure management in place during the year as required by section 65.
- (g) There was no inventory and asset management policy in place as required by section 63.
- (h) The prior year fruitless and wasteful expenditure was neither disclosed nor raised as debtor as required by section 125(2)(d).
- (i) The financial statements on the municipality were not submitted timeously as required by section 126(1).

12. Municipal Systems Act (MSA)

The following are the instances of non-compliance with MSA that were noted:

- (a) No framework is in place to assist with monitoring of the budget, strategic plans and business risk.
- (b) The municipality has not developed or adopted appropriate systems and procedures to ensure fair, efficient, effective and transparent personnel administration that covers the following:
 - The recruitment, selection and appointment of persons as staff members.
 - The monitoring, measuring and evaluating of performance of staff.

13. Internal control

Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment	Control risk	Internal control deficiencies	Objectives
Basis for qualification of opinion					
Property, plant and equipment					

Reporting item	Controlled by the auditor	Assessed by the auditor	Controlled by the audited entity	Controlled by the audited entity and the auditor	Not controlled by the audited entity or the auditor
Asset register issues	X		X		X
Inherited asset not recognized	X			X	X
Commitments					
Commitment not supported	X	X	X		
Payable					
Salaries	X	X	X		X
Condition grants	X	X	X		X
Suspense accounts	X	X	X		X
Receivables					
Difference between balance and aging analysis	X	X	X		X
Consumer debtor provision understated	X	X	X		X
Validity of debtors	X	X	X		X
Debtors suspense not cleared	X	X	X		X
Debtors with credit balance	X	X	X		X
Salary related debtors	X	X	X		X
Land sales debtors	X	X	X		X
Staff debtors	X	X	X		X
Vat discrepancies noted	X	X	X		X
Financial statement					
Financial discrepancies	X	X	X		X
Other matter					
Non-compliance with laws and regulation		X	X		X

Investigation in progress

14. An investigation is being conducted into alleged irregularities by the Municipal Manager during the financial year. The municipal manager was suspended pending the outcome of the investigation. The investigation was still ongoing at the date of this report.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

15. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

16. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

17. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the MSA.
18. In terms of the foregoing my engagement included performing procedures of an audit to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
19. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

20. Internal auditing of performance measurements

The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurements as part of its internal audit processes, as required in terms of section 45 of MSA.

21. Non-existence of a performance audit committee

The municipality did not appoint and budget for a performance audit committee neither was another committee utilised as the performance audit committee.

22. No performance reports compiled during the year

The municipality did not submit an annual performance report as required by section 46 of the MSA. Consequently, the municipality's performance against any measurable performance objectives was not audited, as required by section 45(b) of the MSA.

23. Integrated development plan (IDP)

The following shortcomings were noted with regard to the IDP:

- The development strategies of the municipality were not aligned with national or provincial requirements in terms of section 26(d) of the MSA.
- The financial plan per the IDP did not agree to the budget.
- The IDP did not disclose the performance indicators or targets against which the performance of the municipality should be measured, as required in terms of section 26(i) of the MSA.

- The progress of projects in the service delivery and budget implementation plan was not monitored on a regular basis.

APPRECIATION

24. The assistance rendered by the staff of the Dannhauser Municipality during the audit is sincerely appreciated.

Auditor-General

Pietermaritzburg

15 January 2008



A U D I T O R - G E N E R A L